

Can Teachers Qualify for Minister's Taxation?

In the Internal Revenue Code, Congress has provided ministers with unique tax attributes such as housing allowance, exemption from income tax withholding, exemption from FICA and Medicare, subjection to SECA, and the option to exempt out of SECA. Despite the variances in statutory terminology, these attributes are a “package deal.” In other words, a minister qualifies for all of the attributes or for none.

Key factors to consider when determining whether a teacher qualifies as a minister for tax purposes include the following. (Note that we refer in this article to “teachers,” but the same principles would apply to a school administrator.)

Status Test – The teacher must be “ordained, commissioned, or licensed” as a minister by a church.

Tasks Test – The teacher must be performing the duties of a minister under one of the three options described below.

This article does not address housing allowances specifically. The same issues would apply to a qualifying teacher at a school, as would apply to a minister working for a church.

Status Test

Essentially, this test considers whether a church has set the teacher apart as a minister according to the church's criteria and forms. The phrase “ordained, licensed or commissioned” encompasses the variety of ways churches refer to the process or ceremony used to identify their ministers.

Generally, a school could obtain and rely on a copy of the teacher's ordination, commissioning or licensing certificate to meet this requirement.

A teacher cannot be ordained, licensed or commissioned, however, just to obtain a housing allowance. The teacher's certificate must qualify them with substantially all of the attributes of a regular minister in the church that issued the certificate. There have been several cases and rulings about this. Informally, these may be summarized

as: “Would the teacher be considered a real minister by the church that issued the certificate?” If there is doubt about the legitimacy of the teacher's status, tax counsel should be consulted.

Tasks Test

There are three ways an individual may qualify as performing the duties of a minister:

1. The person may be leading worship and performing the sacerdotal duties (as defined by his church) on behalf of the school. (Available regardless of whether the school is related to a church.)
2. The person may be engaged in professional or executive roles for a church or an integral agency of a church. (Available only for a school that is part of a church or closely related to a church.)
3. The person may be employed due to an assignment by his church.

A minister performing substantial sacerdotal functions on behalf of the school may qualify regardless of whether the employer is a church or not. The teacher's duties would need to include a substantial number of direct, fairly traditional types of ministry activities on behalf of the employer.

In a school setting, a teacher working substantially full-time as a chaplain or a Bible teacher would qualify for minister treatment under this provision, even in a school completely independent of any church. Other teachers in an independent school, however, would not qualify under this provision, even though they teach math, social studies, etc. from Biblical perspective and incorporate the Bible into their lessons.

A professional (i.e., teacher) or executive (i.e., school administrator) working for a church or integral agency of a church can qualify for minister tax treatment, even though their work does not involve worship or sacerdotal duties. For this purpose, a school that is part of the church entity would be considered a church.

Schools that are controlled by or very closely associated with a specific church or church denomination will usually

qualify as an "integral agency of a church." The IRS provided criteria Revenue Ruling 72-606.

The IRS has said that absence of one or more attributes will not automatically disqualify an organization.

1. The church incorporated the school;
2. The school's name indicates a church relationship;
3. The church continuously controls the school;
4. The school's directors must be approved by the church;
5. The school's directors may be removed by the church;
6. Annual reports of finances and operations of the school must be made to the church;
7. The church financially supports the school; and
8. If the school dissolves, its assets would go to the church.

A church may assign one of its ministers to work for another organization, such as an independent school, and the minister will continue to qualify for minister treatment as if employed by the church, even if teaching "secular" subjects or working as an administrator.

There are a number of uncertainties and gray areas associated with assignments. In most situations, tax counsel will be needed to assess whether the assignment will qualify. We believe the following elements are essential for an assignment to be effective for tax purposes:

1. The assignment must occur at the inception of the relationship between the teacher and the school. Some believe the church must recruit and select the minister for the position.
2. The tasks the minister performs must further the ministry purposes of the church making the assignment.
3. The assigning church must have a strong relationship to the minister, probably requiring that the assigning church be the church that ordained, licensed or commissioned the minister.
4. The assigning church must have an ongoing involvement with the teacher and the school. Generally, the church would have some relationship to the school in addition to the assignment of a minister.

Hazards of Misclassification

If the IRS audited the teacher or the school and disallowed a housing allowance on the premise that it was not paid as compensation to a minister, then none of the other minister tax attributes would apply, either.

For the employer, the potential risks of this misclassification include:

1. The employer would have failed to withhold the required FICA and Medicare taxes and to pay the employer share of these, and perhaps have failed to withhold federal and state income taxes, at least with respect to the housing allowance.
2. For failure to withhold these payroll taxes, the employer is potentially liable for the full amount of taxes, plus penalties and interest charged for late payment.
3. Typically, the IRS audits and assesses taxes for three years.
4. A school with multiple misclassified teachers might owe taxes associated with all of them for the past three years.

For the teacher, the potential risks of misclassification include:

1. The teacher would be required to file amended tax returns to show both the housing allowance and any other wages received as gross wages.
2. The teacher would owe federal and state income tax on unreported wages.
3. There would be penalties and interest for late payment, often for the past three years.

While correctly classifying your employees as ministers can be a complex task, taking the elements we've outlined here under consideration will help you avoid the risks of misclassification and ensure that your ministers continue to receive tax benefits.

Decision Tree for Assessing Minister Tax Status

The following is simplified and biased to provide a conservatively safe tax treatment.

1. Does the school have a copy of the teacher or administrator's certificate of ordination, license or commission?
2. If No, then the teacher or administrator cannot qualify for minister tax treatment.
3. If Yes, is there any reason to believe the church that ordained, licensed or commissioned the person considers them to be less than fully qualified to perform all the normal minister duties of the church?
4. If Yes, consult tax counsel.
5. If No, is the school part of a church entity, or an integral agency of a church?
6. If Yes, then the teacher or administrator qualifies for minister tax treatment.
7. If No, does the teacher or administrator engage in leading worship or other traditional minister activities as nearly all of their assigned duties?
8. If Yes, then the teacher or administrator qualifies for minister tax treatment.

9. If No, was the teacher or administrator assigned to the school by a church at the beginning of the teacher or administrator's employment?
10. If No, then the teacher or administrator does not qualify for minister tax treatment.
11. If Yes, consult with tax counsel to consider whether the 'assignment' is likely to qualify.

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